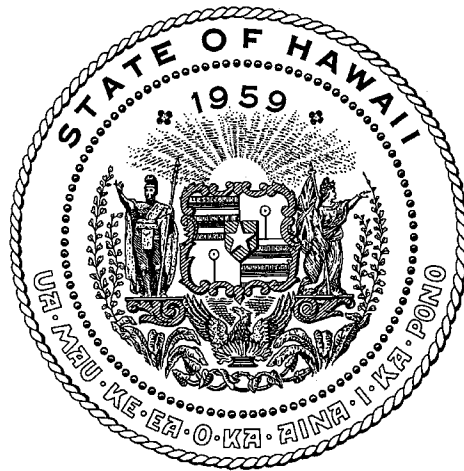


STATE OF HAWAII



THE EXECUTIVE BUDGET SUPPLEMENTAL (Budget Period 2009-2011)

Submitted to the Twenty-Fifth State Legislature
December 2009

EXECUTIVE CHAMBERS

State Capitol

Honolulu, Hawaii 96813

**GOVERNOR'S MESSAGE TO THE 25TH STATE
LEGISLATURE OF HAWAII MEETING IN THE REGULAR
SESSION OF 2010**

In compliance with Article VII, Section 9, of the Hawaii Constitution, I hereby submit to the State Legislature the Executive Supplemental Budget for Fiscal Biennium 2009-11 and the updated Program and Financial Plan for the period 2009-15.

This Supplemental Budget proposes a number of significant changes and adjustments to Act 162, SLH 2009, the General Appropriations Act of 2009, which authorized funding for the two-year fiscal period that began on July 1, 2009 and ends on June 30, 2011.

Much has changed in the past two years. The severe recession of 2008 swept across the nation and many parts of the world with unanticipated force and brought with it enormous challenges for governments at all levels. Its devastating effects on businesses and employment are still being felt today. The national Gross Domestic Product (GDP) began its downturn in the first quarter of calendar year 2008 and ended in the fourth quarter with essentially no growth. The year 2009 saw continued deterioration to a -1.4% decline in the first quarter and -2.4% in the second quarter. The recent improvement in third quarter GDP is the first encouraging sign in a long time and its sustainability is not yet known.

National and global economic events have had a profoundly adverse impact on Hawaii. The tourism industry has suffered severe setbacks. Visitor arrivals decreased by double-digits throughout most of 2008 and the first half of 2009. Private construction building permits went into negative territory for the same time period. Hawaii's unemployment rate, which had stayed consistently below 3% since 2004 and had been among the lowest

in the nation, doubled to 6.5% in the first months of 2009. It was at 7.0% in November 2009. After years of extraordinary growth when Total Personal Income (TPI) was in the range of 6% to 8% annual gains, Hawaii's TPI registered essentially no improvement in the first half of 2009.

Reflecting the contraction in the economy, State tax revenue collections have also been on a steep decline. General fund tax revenues fell by -9.5% in FY 2009 and are projected by the Council on Revenues (COR) to decrease by an additional -2.5% in the current FY 2010.

This is the economic and fiscal environment we have confronted during the past two years. As a State, we have had to take difficult but necessary actions to meet Hawaii's critical needs in these challenging times while dealing with historical revenue declines.

Starting with the execution of last year's budget (FY 2009), our Administration responded quickly to limit the State's exposure to the unfolding economic and fiscal uncertainties. First, hiring restrictions went into effect for all programs except those affecting public health and safety. Second, a general fund restriction of 4% on discretionary operating costs was applied to all departments. Third, restrictions were placed on specific appropriations outside of the budget. These were the beginning steps of a deliberate and prudent fiscal policy to control State spending and keep it in line with lower revenue expectations.

These restrictive measures continued when additional spending reductions were imposed (2% in January 2009 and 2% in May 2009) as we developed the budget for the Fiscal Biennium 2009-11. Sharply declining State revenues required the most severe budget reductions in recent history. General fund operating costs were cut by \$270 million over the biennium. The 2009 Legislature further reduced the Executive Branch biennium budget by an additional \$173 million in response to lower revised revenue projections by the COR during the session. These cost cutting decisions and various revenue generation actions by the Legislature and the Administration were instrumental in averting a serious budget shortfall at the end of FY 2009.

However, the fiscal crisis continued as we began the new fiscal biennium on July 1, 2009 with a worse-than-projected revenue picture. Using the official revenue projections from the COR as of June 2009, we had anticipated a budget gap of \$633 million by the end of FY 2011. This number became significantly larger, \$1.19 billion, as a result of the COR's lower revisions in August 2009. The stark reality of continuing declining general fund revenues means the State does not have sufficient resources to cover all expenditures that previously had been authorized for the new FB 2009-11 budget. The gap between projected revenues and actual appropriations must be closed to satisfy the constitutional requirement of a balanced budget. This is our paramount responsibility for the current fiscal biennium, recognizing we have an obligation to do so in a manner that protects the core functions of State government.

REVENUE PROJECTIONS

On September 29, 2009, the COR revised its general fund tax revenue projections to reflect a decrease of -1.5% for FY 10 and an increase of 6.5% for FY 11. (The previous projections were 0% and 5.6%, respectively.) To put these numbers in perspective, general fund tax revenues increased by 8.3% in FY 04, 16% in FY 05, 10.9% in FY 06, 3.4% in FY 07, and 1.2% in FY 08; positive growth was reversed by a decrease of -9.5% in FY 09.

On December 17, 2009, the COR revised its projections to reflect a decrease of -2.5% for FY 2010 and an increase of 7.6% for FY 2011. These revisions mean the cumulative general fund budget gap for the current biennium grew by another \$40 million.

In the first five months of FY 2010 (July through November 2009), general fund tax collections decreased by a cumulative -6.5% over the previous year.

We estimate that general fund revenues will not return to pre-recession 2008 levels until FY 2012 at the earliest. Further, because State tax revenues lag behind improvements in the private sector economy, it is possible it will be 2014 before revenues return to pre-recession levels.

REDUCING EXPENSES IN FY 2010

As stated above, our paramount responsibility in the current fiscal biennium is to address a current revenue shortfall of \$1.23 billion. The magnitude of the gap has required a substantial and immediate reduction in operating expenses. For FY 2010, spending restrictions and other administrative measures were implemented on July 1, 2009 to reduce overall spending. These included restrictions on specific appropriations, eliminating cash funding for capital improvements, debt restructuring, and a comprehensive restriction of 13.85% on operating budget appropriations.

Because payroll costs are the single largest category of expenditures in the State budget, accounting for 60% of the budget total, they must be reduced for any plan to effectively close the budget gap. Our original plan to implement a furlough of all State employees for 3 days a month was blocked. This furlough plan would have saved an estimated \$680 million in general funds for the biennium.

To achieve needed payroll savings, a reduction-in-force (RIF) was initiated in August 2009. I was personally saddened by the necessity to take this action and understand the hardship it has

created for those affected by the RIF. However, the State had few options to achieve immediate payroll savings.

Concurrently, collective bargaining discussions were pursued with the Hawaii State Teachers Association (HSTA), the Hawaii Government Employees Association (HGEA) and the United Public Workers (UPW) to arrive at contract agreements for the biennium. Contracts with the HGEA and the HSTA allow for furloughs averaging two days a month over the biennium. General fund savings on payroll costs including fringe benefits from the furlough plan are estimated to be \$170.7 million in FY 2010.

The combination of all the above actions - - restrictions, debt restructuring, RIF, furlough and other administrative measures - - is expected to reduce general fund spending by a total of \$452.3 million in FY 2010. This is a critical step toward closing the budget gap but it is not enough to close the shortfall completely. The following additional actions are needed in order to balance the 2010 budget and reflect a projected \$60.3 million ending fund balance:

1. Transfer excess balances from special funds. Our most recent review of non-general fund accounts indicates a potential \$10 million in excess balances that can be transferred to the General Fund.
2. Delay payment of income tax refunds within the legally allowed 90-day period starting in 2010. This option would provide a one-time savings of \$275 million in FY 2010.
3. Refinance and restructure G.O. bond debt. The refinancing of debt which was recently completed in November 2009 yielded a total of \$97.3 million in savings for the biennium. Additional refunding and restructuring will reduce debt service costs by \$18.6 million in FY 2010.
4. Review expenditure plans and lapse excess authorizations as applicable. We will continue our efforts to closely monitor

program expenditure plans to eliminate unnecessary spending and lapse any excess appropriations.

REDUCING EXPENSES IN FY 2011: SUPPLEMENTAL BUDGET REQUESTS

We must continue pursuing labor cost reductions and are redoubling our efforts to reshape State government to focus on essential and critical services. Our objective is to realign State programs and services with available resources and place the State budget on a sustainable path. The austere financial environment that we face requires nothing less.

As an integral part of budget preparation, departments and agencies have been directed to continue a critical review and re-assessment of programs to determine the core functions and essential services of State government. The overall target is a 13.85% reduction in general funded operating costs for FY 2011. Special funded programs are also required to operate under a ceiling and trim their expenses.

For capital improvements, the current level of authorizations is substantial and is deemed adequate for the biennium. Requests for new funding and projects have been kept at a minimum to curtail borrowing costs. Departments have been instructed to accommodate their capital improvement program (CIP) needs through lapses and trade offs of existing capital improvement program appropriations.

The Executive Supplemental Budget requests for FY 2010-11 are summarized below.

	FY 11 <u>Appropriations</u> (\$million)	FY 11 <u>Adjustments</u> (\$million)	FY 11 <u>Requests</u> (\$million)
Operating Budget			
All means of financing (MOF)	10,467.3	(378.2)	10,089.1
General Fund	5,267.6	(348.3)	4,919.4
Capital Improvements			
All MOF	972.3	164.9	1,137.2
G.O. Bonds	185.8	46.3	232.1

The Operating Budget

The Executive Supplemental Budget submission for FY 2011 reflects the following actions:

1. **Reduce State payroll costs.** A total of 1,990 positions (1,693 permanent and 297 temporary) are proposed for elimination. A total of 792 of these positions are vacant. The distribution by departments and means of financing (MOF) is presented in the Appendix that follows. While every department is affected, the biggest reductions are in the largest general funded programs: Health, Human Services, Public Safety, Accounting and General Services, and Agriculture. The reduction includes the following components:
 - Elimination of 792 vacant positions (\$29.2 million saved from all MOF, \$11.1 million in general funds).
 - Elimination of up to 1,198 positions identified for layoffs under the August 2009 RIF plan (\$48.8 million saved from all MOF, \$42.7 million in general funds).
 - Adjustment in the number of positions that were affected by program changes due to reduction, restructuring, or MOF changes.

For the Department of Education (DOE), the University of Hawaii (UH), and the Hawaii Health Systems Corporation (HHSC), their respective governing boards were given latitude as to how to implement a 13.85% reduction in operating expenses.

The overall changes to the State's workforce are summarized below.

	<u>General Fund</u>	<u>Other MOF</u>	<u>Total</u>
Number of reductions	1,402	588	1,990
Permanent	1,263	430	1,693
Temporary	139	158	297
Filled positions	1,023	175	1,198
Vacant positions	379	413	792

2. **Pursue other labor cost savings through collective bargaining negotiations.** Another means to reduce payroll expenses is through curtailment of working days. The new contract with the HGEA implements a furlough of up to 24 days in FY 2011, and the HSTA contract includes furloughs of 17 or 21 days depending on whether the employee is a 10-month or 12-month worker. While negotiations are still pending with other unions, the departments and agencies their members work for are held to the same level of savings that can be expected from a comparable furlough. Overall payroll reductions including fringe benefits are estimated to be \$198.4 million from general funds.
3. **Align program requirements with appropriate means of financing.** We have identified additional programs and activities that appropriately should be funded with revenue sources other than general funds. As a result, 22 positions and related program expenses are proposed to be funded by various federal and non-general fund sources. General fund savings of \$15 million each year are derived from the following changes:

- In the Cash Support for Families program (HMS 211), two-parent cases are moved from general funds to federal funds under the Temporary Assistance for Needy Families (TANF) program (\$7.6 million).
 - In the Cash Support for Child Care program (HMS 305), childcare expenditures are moved from general funds to TANF funds (\$5.5 million).
 - In Plant Quarantine (AGR 122), funding for Inspectors is changed from general funds to special funds generated by program fees (22 positions and \$1.7 million).
4. **Reduce operating costs, restructure programs, and preserve essential services of State government.** As revenues continue to decline, the State cannot stay on its current course and maintain the same level of services. Reductions in general funded programs will be achieved through: consolidating and streamlining operations, rolling back non-essential or recently added services, eliminating programs of low priority, and reducing levels of benefits. Adjustments occur in the following areas:

Department of Agriculture

- Elimination of the Agricultural Statistics Services Branch and the Market Analysis and News Branch.
- Deletion of 30 Inspector positions (28% reduction) in the Plant Quarantine program.

Department of Health

- Abolishment of Dental Hygiene Services. Preventive services to students will no longer be offered.

- Abolishment of the Community Health Division and consolidation of services into the Tobacco Settlement program account.
- Restructuring and merging existing services into a new General Medical and Prevention Services Division.
- Reduction of 37 permanent positions (20% reduction) in the Adult Mental Health program for outpatient services.
- Reduction of 62 permanent positions (36% reduction) in the Family Health Services program.
- Reduction of 23 permanent positions (89% reduction) in the Public Health Nursing program relating to school health aides.
- Reduction of 37 permanent positions (63% reduction) in the Vector Control Branch.

Department of Human Services

- Elimination of HMS 212 (Cash Support for Aged, Blind, and Disabled Individuals) and consolidating services into HMS 202 (Aged, Blind, and Disabled Payments) and HMS 204 (General Assistance Payments).
- Curtailment of benefits in the Medicaid Adult Dental Services program to include emergency dental services only.
- Reduction of healthcare costs through implementation of managed care and the new Basic Health Hawaii plan.
- A reduction of 113 permanent positions (38% reduction) in the Medicaid program.

Department of Accounting and General Services

- Deletion of 57 permanent positions (30% reduction) in the Information Processing and Communications Services program.
- Deletion of 49 permanent positions (33% reduction) in the Custodial Services program.

Department of Public Safety

- Closing of Kulani Correctional Facility on Hawaii and assigning 81 permanent positions (from a total of 91) to other facilities.

Two significant programs will continue to require further monitoring:

- Medicaid. Proposed appropriation levels for FY 2011 have been established using the best assumptions available regarding enrollment growth and cost containment. These assumptions may be revised if enrollment and costs exceed our current projections.
 - The Hawaii Health Systems Corporation. Proposed funding from general funds is at the level authorized for FY 2011. Any adjustment will have to be addressed during the 2010 Legislative Session.
5. **Maximize the use of federal funds.** Hawaii is receiving a substantial amount of federal assistance under the American Recovery and Renewal Act of 2009 (ARRA). A total authorization of \$943 million was included for the biennium in Act 162, SLH 2009, to provide additional operating funds for higher and lower education, unemployment insurance and workforce development, health and welfare, renewable energy and environmental management, housing, and transportation. Another \$19.8 million is requested in the Supplemental Budget

to increase the federal ceiling for ARRA funds being received by the Housing Finance and Development Corporation. We continue to explore and maximize the opportunities for additional federal grants under ARRA as well as through traditional federal programs.

6. **Continue the restructuring and refinancing of G.O. bond debt.** Debt restructuring has been an important tool of fiscal management as we seek to find market opportunities for reducing the debt service costs of the State's borrowing program. For FY 2011, a restructuring program will provide significant savings and result in lower debt service costs.

The Capital Improvement (CIP) Budget

The capital improvement plan for FY 2011 continues to focus on an expanded Major Repair and Maintenance program aimed at getting projects done quickly to address the repair and maintenance backlog and help with job creation. Priority is given to projects currently in progress or nearing completion and projects that improve energy efficiency or contribute to the development of clean energy alternatives for Hawaii. In the area of transportation, we will continue to make modernization plans for airports and harbors high priorities.

In an effort to update and eliminate project authorizations that are no longer necessary, we have identified a total of \$70.2 million in existing CIP appropriations that are designated to lapse.

New requests for capital improvements include the following significant projects:

- A new facility for the College of Hawaiian Language at the University of Hawaii at Hilo (\$31 million)
- Facility repair and maintenance and construction for public charter schools (\$10 million), including \$2.2 million for health

and safety, \$6.0 million for classroom renovations, and \$1.8 million for relocating charter schools to public facilities

- Renovation of the Kulani facility and infrastructure to develop a new Youth Challenge Academy on Hawaii (\$1.8 million)
- Capitalization loans for safe drinking water projects (\$6.5 million)
- Capitalization loans for wastewater projects (\$12.7 million)
- Improvements to Honolulu International Airport, Elliot Street support facilities (\$50.9 million)

PROPOSALS TO ADDRESS THE BUDGET AND REVENUE SHORTFALL IN FY 2011

As substantial as our proposed actions are in FY 2011, these reductions are not sufficient to close the budget gap. We must consider, in this legislative session, other options for generating the revenues needed for basic support of State programs and services. Thus, in addition to the spending reductions being proposed, I am recommending that we take the following actions:

1. Refinance and restructure G.O. bond debt. Additional refunding and restructuring will reduce debt service by \$75.2 million in FY 2011.
2. Suspend distribution of revenues from the Transient Accommodations Tax (TAT) to the counties. TAT taxes are currently earmarked for several purposes: funding the operations and marketing programs of the Hawaii Tourism Authority and the Hawaii Convention Center, and giving financial aid to the counties. I am recommending that distribution to the four counties be suspended until the State regains its fiscal balance.

3. Implement tax measures to reform and improve Hawaii's tax system. Legislative proposals will be submitted to make Hawaii's tax system more efficient and equitable, to tighten up tax rules, and to improve tax administration. The total tax package, including the TAT proposal, is an integral part of the General Fund Financial Plan and is estimated to generate \$178.3 million in additional revenues for the State in FY 2011.

Taken together, the proposed actions summarized above are expected to generate a significant stream of additional revenues for the State and will enable us to achieve a positive balance in the General Fund for FY 2009-11 and for each year of the planning period.

These are difficult but necessary steps that we must take in order to navigate the fiscal crisis the State faces, and to meet our legal obligation to produce a balanced budget as required by the State constitution.

In these truly challenging times, I am encouraged by the positive credit ratings that Hawaii continues to receive from all three major rating agencies. In October 2009, Hawaii received a rating of "AA" from both Standard and Poor's Ratings Service and Fitch Ratings, and "Aa2" from Moody's Investor Service. These positive ratings reflect the assessment of these nationally recognized firms that Hawaii State government has consistently displayed prudence and responsibility in fiscal management and governance.

We are committed to making the hard decisions and setting a responsible course that leads Hawaii through this critical period toward a brighter future.

With aloha,


LINDA LINGLE
Governor of Hawaii

APPENDIX TO THE GOVERNOR'S MESSAGE

A. THE EXECUTIVE SUPPLEMENTAL BUDGET RECOMMENDATIONS

THE OPERATING BUDGET

All Means of Financing

For **FY 11**, total proposed adjustments to the operating budget amount to a net decrease of \$378.2 million, or 3.6%, from all means of financing, as shown below.

Means of Financing	FY 11 Act 162/2009 Appropriation (\$)	FY 11 Proposed Adjustment (\$)	FY 11 Recommended Appropriation (\$)
General Funds	5,267,648,691	(348,294,916)	4,919,353,775
Special Funds	2,504,362,703	(30,087,726)	2,474,274,977
Federal Funds	1,772,522,731	(18,230,466)	1,754,292,265
Private Contributions	433,067	.....	433,067
County Funds	674,179	.....	674,179
Trust Funds	67,648,676	(559,531)	67,089,145
Interdept. Transfers	193,297,512	(3,773,695)	189,523,817
Federal Stimulus Funds	263,661,986	26,407,961	290,069,947
Revolving Funds	385,019,552	(2,964,845)	382,054,707
Other Funds	<u>12,060,876</u>	<u>(714,605)</u>	<u>11,346,271</u>
Total	10,467,329,973	(378,217,823)	10,089,112,150

The distribution by department and the significant changes in the Operating Supplemental Budget by department are presented in the sections that follow.

General Fund

For **FY 11**, total proposed general fund adjustments to the operating budget amount to a net decrease of \$348.3 million, or 6.6%, less than the current appropriation level. The distribution by department is presented in the sections that follow.

It should be noted that nearly three-quarters (\$253.4 million) of the decrease is due to reductions in payroll costs.

Decrease in Positions

The Supplemental Budget includes significant decreases in the number of permanent positions and temporary positions:

	<u>Permanent</u>	<u>Temporary</u>	<u>Total</u>
Total adjustments ^{1/}	(1693)	(297)	(1990)
By means of financing:			
General Funds	(1263)	(138)	(1401)
Special Funds	(102)	(27)	(129)
Federal Funds	(315)	(88)	(403)
Revolving Funds	(10)	(16)	(26)
Interdepartmental Transfers	(3)	(28)	(31)

	<u>Permanent</u>	<u>Temporary</u>	<u>Total</u>
By department:			
Accounting & General Services	(156)	(1)	(157)
Agriculture	(96)	(3)	(99)
Attorney General	(40)	(6)	(46)
Budget & Finance	(11)		(11)
Business, Econ Dev & Tourism	(36)	(14)	(50)
Commerce & Consumer Affairs	(3)		(3)
Defense	(25)	(3)	(28)
Education			
Education – Charter Schools			
Education – Libraries			
Governor		(4)	(4)
Hawaiian Home Lands	(3)		(3)
Health	(338)	(28)	(366)
Health - Hawaii Health Sys Corp			
Human Resources Development	(20)		(20)
Human Services	(522)	(17)	(539)
Labor & Industrial Relations	(127)	(118)	(245)
Land & Natural Resources	(61)	(21)	(82)
Lieutenant Governor			
Public Safety	(148)	(3)	(151)
Taxation	(33)	(74)	(107)
Transportation	(74)	(5)	(79)
University of Hawaii			

¹ / Totals may differ due to rounding.

THE CAPITAL IMPROVEMENT (CIP) BUDGET

For **FY 10**, total proposed CIP adjustments amount to a decrease of \$30.4 million in general obligation bond funds, reducing the current general obligation bond appropriation level from \$678.2 million to \$647.8 million.

For **FY 11**, total proposed CIP adjustments amount to \$164.9 million, to be funded from the following sources:

<u>Means of Financing</u>	<u>FY 11 Act 162/2009 Appropriation (\$)</u>	<u>FY 11 Proposed Adjustment (\$)</u>	<u>FY 11 Recommended Appropriation (\$)</u>
General Funds	.....	.....	.....
Special Funds	92,986,000	3,000,000	95,986,000
G.O. Bonds	185,810,000	46,298,000	232,108,000
G.O. Reimbursable	.....	.....	.....
Revenue Bonds	502,557,000	25,170,000	527,727,000
Federal Funds	138,248,000	54,467,000	192,715,000
Private Contributions	3,100,000	.....	3,100,000
County Funds	2,000	.....	2,000
Interdept. Transfers	.....	.....	.....
Federal Stimulus Funds	.....	.....	.....
Revolving Funds	.....	.....	.....
Other Funds	<u>49,600,000</u>	<u>36,000,000</u>	<u>85,600,000</u>
Total	972,303,000	164,935,000	1,137,238,000

The distribution by department and the highlights of the CIP program by department are presented in the sections that follow.

The CIP requests reflect the continued commitment of the State to improving its infrastructure and capital assets to support the economic base and maintain the health, safety, and quality of life in Hawaii.

B. THE GENERAL FUND FINANCIAL PLAN

The General Fund balance was initially determined to be at \$8.0 million on June 30, 2009. Subsequently in September 2009, an error was discovered in the recording of certain tax collections. This error resulted in an overstatement of general fund revenues of \$800,000 in FY 08 and \$44 million in FY 09. With these revisions, the FY 09 general fund balance was changed from a projected positive \$8.0 million to an actual minus \$36.8 million. This is a decrease of \$367.2 million from the previous year, reflective of the decline in revenues due to the global recession.

The General Fund Six-Year Financial Plan shows positive balances for both FY 10 and FY 11, as well as the four subsequent years. Although the Council on Revenues projects that revenues in FY 10 will be less than previously anticipated, they expect an improvement starting in FY 11. Other actions contributing to the positive balances include:

- Executive Branch budget reductions and adjustments as proposed.
- Legislative approval and authorization for Administration proposals that have revenue and expenditure impact.

C. THE GENERAL FUND EXPENDITURE CEILING

By law, general fund appropriations must comply with the expenditure ceiling requirements that are set forth in Section 9 of Article VII of the State Constitution and Section 37-92 of the Hawaii Revised Statutes.

At the aggregate level that includes all branches of government, total proposed appropriations from the General Fund are within the expenditure ceilings for both FY 10 and FY 11.

For the Executive Branch, total proposed appropriations from the General Fund (which include the Executive Supplemental Budget for FY 2009-11 and other specific appropriation measures to be submitted) are also within the Executive Branch's appropriation ceiling in both FY 10 and FY 11.

D. THE DEBT LIMIT

Section 13 of Article VII of the State Constitution places a debt limit on G.O. bonds that may be issued by the State. It has been determined that the total amount of principal and interest calculated on: a) all bonds issued and outstanding, b) all bonds authorized and unissued, and c) all bonds proposed in the Supplemental Budget

(including State guaranties) will not cause the debt limit to be exceeded at the time of each bond issuance.

The Declaration of Findings with respect to the G.O. bond debt limit is presented in the sections that follow.